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ABSTRACT

The role of evaluation in the profit and loss sector of American economy differs from its role in the nonprofit sector. Since corporate industry and private foundations contribute approximately 4.5 billion dollars to help finance the ninety-billion dollar private nonprofit sector, sound planning and evaluation activities are essential to maintain the quality and independence of nonprofit institutions' activities. Planning and evaluation might take place in five stages: (1) research designed to improve our understanding of the world; (2) definition of values and identification of goals; (3) development of policies, projects, and programs to achieve these goals; (4) implementation of these programs; and (5) summative evaluation. Some of the differences between private businesses and nonprofit institutions occur because the primary constituencies of a business--its customers and stockholders--are external to the business; and because external regulatory agencies and consumer organizations scrutinize private industry. Internally-conducted evaluations of a private business demonstrate its orientation toward the future. Private, as compared to nonprofit institutions, are more interested in evaluating their competitors, in preliminary testing of ideas, and in cost effectiveness analysis. Private institutions may also experience greater internal consistency in goals than an agency which is regulated externally. (GDC)

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EVALUATION AND PRIVATE PHILANTHROPY: VIEW FROM A CORPORATION

An Invited Paper Presented at

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By

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EVALUATION AND PRIVATE PHILANTHROPY

When Mary Hall invited the three of us to say something about evaluation and private philanthropy, we thought it would be useful, as part of that exercise, to examine the role of evaluation in the profit and loss sector of our economy and compare it with evaluation practices in the non-profit sector. As a businessman with some six years experience in managing the corporate philanthropy of Exxon Corporation and the Exxon Education Foundation I was given this assignment.

In looking at the philanthropic programs of American corporations and of public foundations, I was struck by the fact that I knew of only one or two corporations and only five or ten foundations which have established planning and evaluation functions on a systematic and structured basis. This is in marked contrast to the importance attached to ongoing planning and evaluation activities in business institutions. What is the reason for this difference? To get at the answer of this question I think it is necessary to take a closer look at the structure and functioning of businesses and non-profit institutions.

A convenient way to do this is to divide up the economy into three sectors, as summarized on Vu-graph I:

1) The Exchange Economy covers voluntary two-way transfers of goods and services, generally through purchase and sale for money; this is probably the largest sector of the U.S. economy; most of the transactions of business institutions fall within this sector of the economy;

2) The Coercive Grants Economy comprises involuntary one-way transfers of money, goods and services. These are sometimes carried out without legal sanction as criminal acts such as thefts. Or they may be politically sanctioned collective re-distributions of wealth by government. These can be financed through collectively sanctioned but individually coercive one-way grants in the form of taxes or through the printing by government of new money with the redistribution through one-way grants. Alternatively, collection and redistribution may take place by acts of government which alter market prices through subsidies, price controls, restrictions on entry or other regulatory controls; these are sometimes called implicit or hidden grants; this coercive sector is probably the fastest growing and least understood sector of the U.S. economy; and finally

3) The Non-Coercive or Philanthropic Grants Economy comprises voluntary one-way transfers of money, goods and services. These may flow from individuals, from foundations or from corporations in the form of one-way grants to private and public tax-exempt institutions. If we set aside that portion of this sector which represents private voluntary support of governmental institutions, such as public universities, the balance of this sector represents about $30 billion or 1.4% of GNP. This $30 billion dollars helps finance privately controlled tax-exempt organizations with total revenues of about $107 billion a year

of which roughly $90 billion is for non-religious activities. This is based on a quick and rough extrapolation of some data published in 1975 by the Filer Commission. This $90 billion dollar non-profit sector of our economy represents roughly 4.3% of GNP. As shown on Vu-graph II, this $90 billion is financed roughly 37% by government grants, with the balance coming 13% from individuals, 2% from corporations, 3% from public foundations, 2% from endowment income and 43% from other sources, principally fee income.

My comments about evaluation and private philanthropy relate to this 4.5 billion dollars of corporate and foundation grants and the $90 billion private non-profit sector it helps finance. I mention its modest size not only to put it in perspective but to underline the importance of soundly conceived planning and evaluation in the operation of private philanthropy if it is to play an effective role in helping to maintain a creative and experimental non-profit sector in a condition of constructive interdependence, independent of domination from any single source of financing and influence.

Private philanthropy, then, represents roughly 4½ billion dollars a year dedicated in one way or another to the well-being of mankind. Evaluation can play a meaningful role at each stage of the continuing planning and evaluation cycle which should govern a well organized philanthropic activity.

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As conventionally conceived, these planning and evaluation stages might include five stages, as summarized on Vu-graph III:
1) Science and social science research designed to improve our understanding of the world and how it works and sometimes seeking to do so through the construction of simplified models of reality. One of the principal pitfalls of philanthropic activity both governmental and private, at this stage of planning and evaluation is the delusion that relevant facts and relationships are knowable. Another is a tendency to oversell and underplan in areas of ignorance.

2) A second stage which can be helped by thoughtful planning and evaluation involves the definition of values and the identification of goals or desired changes in the system. These changes are presumably for the better and are often stated in the form of problems which require solutions. Planning and evaluation at this stage can be helpful in enabling us to avoid adoption of goals which are fundamentally inconsistent with human nature or, at a given point in time may be unattainable because of resource limitations or a conflict with political realities.

3) A third stage is the development of policies, programs and projects to achieve defined goals; evaluation at this stage can influence the kind of proposals that will be submitted to a funding agency and whether or not they will be funded. Evaluation at this stage can also be helpful in avoiding projects

Evaluation at this stage can be helpful in avoiding projects where goals are not clear or where plans are more ambitious than the resources required to administer them. As the saying goes, if you don't know where you're going you're likely to end up someplace else.

4) A fourth stage is the implementation of policies, programs and projects; evaluation at this stage may well involve interaction between the evaluator and those responsible for what is being evaluated with the objective of improving policies, programs and projects while they are underway; this kind of evaluation is sometimes called formative evaluation. A frequent problem at this stage is that those responsible for operation of agency programs are reluctant to risk evaluation that will be critical of their performance, or that will yield answers contrary to their intuitive judgment, or which may be premature. On the other hand, unless those responsible for operations are constructively involved in an evaluation, it will become more difficult to develop timely, relevant information at reasonable cost or to have any current impact on program operations.

5) and finally, there is the summative appraisal of finished work, of completed programs and projects, designed to identify success and failure and the reasons therefore as a prelude to deciding what to do next. Useful evaluation continues to be difficult; causal relationships are difficult to establish;

effects of a given program or project are difficult to separate from outcomes determined by factors outside the program; evaluators sometimes compare outcomes with unrealistic, utopian standards.

The state of the art of philanthropic evaluation, as generally practiced leaves me feeling both modest and skeptical about our ability either to set meaningful goals or, if set, to accurately measure their achievement.

Because the prior art of setting meaningful goals is itself not widespread or fully developed, so the interdependent art of evaluating whether goals have been achieved is already seriously compromised.

Because the proprietary, profit and loss sector of our economy has had extensive experience with planning and evaluation we thought it would be useful to compare this sector and its evaluation practices with those followed in private philanthropy. I will, therefore, devote the balance of my remarks today to such a comparison, concluding with a few comments on some recent developments in the field of philanthropic planning and evaluation which may hold some promise.

In comparing business ventures with those marginally financed by philanthropy, I will make a number of simplifying assumptions to facilitate the comparative analysis. I will start with

some over-all comparisons between proprietary business organizations and non-profit organizations and the role of evaluation in each and then examine in more detail the approach to evaluation in the specific areas of marketing, research and manufacturing and finance.

Of over-riding importance is that the primary constituencies of business organizations are external to the corporation. Survival of a profit-making organization is contingent on its ability to measure up to the evaluative judgment of its customers and its owners, its shareholders. Each member of each of these two groups makes a judgment with each two-way exchange involving the purchase of goods and each decision to buy, sell or hold shares of stock. Of importance here is the difference in ownership between proprietary business organizations which may operate at a profit or a loss and non-proprietary non-profit organizations.

Business organizations whose capital is raised through two-way exchanges, the sale of equity shares, are owned by shareholders. The proprietary whose ownership rights of shareholders can be transferred to others via a two-way exchange. Shareholders receive quarterly and annual reports on the financial results of their investments; these reports constitute an ongoing summary evaluation of the success of their investment. Corporations are also undergoing continuous evaluation by professional financial analysts employed by investment banks,

brokerage firms, bank trust departments, pension funds, insurance companies and creditors.

In addition, profit-making organizations are undergoing continuing scrutiny by a variety of general regulatory agencies ranging from the SEC and the FTC to the IRS as well as other regulatory bodies more highly specialized in their interests such as the FCC, the FDA and OSHA, not to mention ERISA and EEO compliance.

The fact that proprietary business organizations receive equity financing through the purchase of shares automatically subjects them to external evaluation through examination of their return on investment. This is reflected in earnings and the payment of dividends and is evaluated daily through the purchase and sale of their shares and the public daily posting of the prices at which shares are transferred.

The prices of products sold by proprietary business organizations must, over time, recover their total cost, including the cost of capital, sometimes called profits. In addition these products are normally sold in fully competitive markets to customers whose decisions are aided by various private and public consumer organizations which establish standards and evaluate products against these standards.

Non-profit organizations raise capital through one-way exchanges; if dissolved no-one would have residual ownership rights which

could be transferred. They have no obligation to make quarterly reports to shareholders on the financial status of their investments. They have no shares representing ownership rights which are bought and sold with a public posting of prices.

While the financial results of non-profit organizations are reviewed by the IRS and they are also subject to review for compliance with EEO and OSHA regulations, their operations are not normally reviewed by the SEC and the FTC.

Nor are the quality and price of their products generally the subject of intensive evaluation by consumers organizations.

In summary, proprietary organizations, unlike non-profit organizations, undergo ongoing evaluation of their operations by owners, consumer organizations and regulatory bodies which require regular public disclosure of their operating results. They also face the constraint of paying for the cost of invested capital through earnings and the payment of dividends.

These more general observations have been on the differences between proprietary and non-profit organizations in their orientation towards <u>external</u> evaluation. Let me turn now to some differences in <u>internal</u> evaluation practices.

Evaluation practices in proprietary business organizations vary by industry and by firm. Variations also exist within the world of private philanthropy and the non-profit, non-proprietary organizations which they support.

Added to that, my personal experience in both the business and non-profit worlds is considerably short of infinite. Moreover, the comparisons I am about to make have not been illuminated by rigorous or systematic empirical research. In fact, I have assembled no data whatsoever to support my observations. However, to the extent that they find some resonance with your own experience and observations, they may suggest several useful lines of further inquiry.

Proprietary business organizations are engaged essentially in making and selling things. Sometimes the things sold are goods - measured in molecules - and sometimes services - measured in financial, cognitive or affective dimensions. In either case, these activities are carried out and new investment projects are developed through the coordination of a number of functions such as marketing, research amd manufacturing; and they are financed by assembling investment and working capital, all of which takes place under a functional umbrella called management. I thought it would be useful to take a look at the evaluation practices that have evolved within some of these major business functions and compare them with the evaluation practices that have evolved within non-profit organizations. My initial objective is to determine whether there are any significant differences and, if so, whether these differences can be distilled into some generic differences in evaluation practices. If so, it may then be useful to ask a number of further ques-

tions. These questions might cover such ground as: are any of these evaluation practices transferrable? Or are they functions, latent or manifest, particular to the class of institution in which they have evolved? Do they have any relevance to the art of evaluation as employed by private philanthropy? Is it possible to develop a proxy in non-profit institutions for the external evaluation characteristic of proprietary institutions without imposing additional regulatory controls? Or are there broader implications? For example: Should we be more discriminating in deciding under what conditions activities should be carried out in the proprietary or non-proprietary sectors of our economy? Or in the public or private sectors of our economy? And finally, what is the proper role for private philanthropy in seeking to develop solutions for the organization and financing of human needs in a way which is most likely to preserve the viability and autonomy of the useful institutions in our society? While I will not attempt in this paper to answer any of these questions, I think further research and experimentation addressing questions such as these would be useful.

A major difference between proprietary profit and loss organizations and non-proprietary non-profit organizations is their attitude towards time. Business organizations which survive must be strongly oriented towards the future.

The obligation to make continuing future payments of the cost of capital obliges them to attach importance to the time value of money, to evaluate and plan the timing of investments and to forecast and monitor the flow of funds related to investment plans in order to recover the cost of capital within the time periods planned. This obligation has a significant effect on all internal incentives, future plans, controls and evaluation practices.

In contrast, non-profit organizations generally do not use financial evaluation techniques which discount projected future flows of funds so that their present value is maximized. They are less likely to evaluate the impact of proposed investments in terms of discounted future flows of cash.

In summary, non-profit organizations attach less importance than proprietary organizations to evaluation of the time value of future flows of money. Philanthropic grant-making organizations, even those which are nominally oriented towards the support of future creative innovations, often do not give adequate weight to the future. Their investments often are oriented towards short-term periods without the burden of continuing responsibility for the future or the risk of penalty for failure.

Another significant difference between profit and loss and non-profit organizations is in the importance attached to evaluation of competitors. Marketers analyze the share of the market held by competitors, often by class of customer. They analyze their competitors strengths and weaknesses and the quality, price and performance of competitors' products. The research and manufacturing functions analyze the patent and technological position of competitors as well as their production costs. Finance departments analyze competitors financial ratios in order to reveal possible weaknesses in their own operations in relation to competition and to test the realism of their assumptions in developing major new projects.

Profit and loss organizations are competing for investment capital in the same market. Persistent differences in costs compared with competition will dry up sources of new capital. Major endowment campaigns or appeals to annuitants are likely to be unavailing and the kind of bailouts we have recently witnessed with Lockheed and Amtrak presumably should not be taken as precedent setting.

Not only does the profit and loss organization evaluate competitors but it also evaluates competing business strategies. Marketers examine the trade-offs between price, quality and quantity as well as varied rates of market penetration for new products and market share goals before selecting a marketing strategy.

Research and manufacturing departments in developing a new product evaluate alternate process and engineering designs and plant sizes before making an investment decision. Decisions on whether to make or buy a material or a part or to carry out or buy a service are generally made only after comparative cost analyses.

And whenever the decision involves significant cash flows over a long time period, competing strategies are subjected to discounted cash flow analysis.

Vu-graph VI lists three other evaluation practices which, in my experience, tend to be more characteristic of profit and loss institutions than non-profit institutions. The first of these - preliminary testing - describes a tendency towards gradualism and conservatism in moving into new areas. The marketer tests a product for performance and safety before introducing it to the market. Measured against the very highest standards of acceptable risk, sometimes testing is not sufficiently prolonged or thorough to meet those standards. New products are generally test marketed in a limited area before general marketing begins.

In developing a new product, funds are generally limited during the idea development and laboratory feasibility stages and then gradually increased as a project moves into manufacturing process development, pilot plant and semi-commercial production stages.

New financing and portfolio management techniques are generally tested on a limited basis before general adoption.

The concept of preliminary testing, of course, is hardly unique to profit and loss institutions. It may, however, have been more deliberately and systematically employed in the profit and loss sector in the past than in the non-profit sector.

The next column illustrates two approaches to evaluation which are characteristic of profit and loss organizations which are particularly important. 1 - to be most useful evaluation will concentrate on a relatively small number of priority indicators keyed to priority goals and 2 - evaluation will be continuous. For example, marketers will concentrate on price, market share and marketing margin trends.

Manufacturers will concentrate on such indicators as the ratio of product produced in relation to production capacity. What percentage of the time were production facilities not being used and was the downtime planned or unplanned? What are the production costs per unit?

And, most important of all, will be a continuing profit and loss and cash flow analysis as a measure of overall earnings performance.

In contrast, non-profit evaluation has too often been marked by one-time or sporadic evaluation and the use of shifting indicators not keyed to priority goals.

An evaluation problem which is particular to non-profit organizations is that they have internal goals which differ from the goals of diverse funding agencies. While it is true that managers and owners of profit and loss organizations may sometimes have differing objectives, this problem is much more frequently encountered in non-profit organizations.

TRI-PARTITE ORGANIZATION OF ECONOMY

EXCHANGE ECONOMY INVOLVES
VOLUNTARY TWO-WAY TRANSFERS

COERCIVE GRANTS ECONOMY INVOLVES
INVOLUNTARY ONE-WAY TRANSFERS - CRIME
POLITICALLY SANCTIONED COLLECTIVE TRANSFERS WHICH
FINANCED BY COERCIVE ONE-WAY TAXES AND PRINTING NEW MONEY AND
REDISTRIBUTED BY ONE-WAY GRANTS OR

REDISTRIBUTED BY ALTERATION OF MARKET PRICES THRU
SUBSIDIES/PRICE CONTROLS/OTHER REGULATIONS

NON-COERCIVE (PHILANTHROPIC) GRANTS ECONOMY INVOLVES
VOLUNTARY ONE-WAY TRANSFERS
FINANCED BY INDIVIDUALS/FOUNDATIONS/CORPORATIONS AND
ONE-WAY GRANTS TO PRIVATE/PUBLIC TAX-EXEMPT OPERATION INSTITUTIONS

UCB D7/A29

ESTIMATED TOTAL 1978 REVENUE OF PRIVATELY CONTROLLED NON-RELIGIOUS TAX-EXEMPT OPERATING INSTITUTIONS TO WHICH DONORS' GRANTS ARE TAX-DEDUCTIBLE

			PRIVATE					
	TOTAL	GOVT	TOTAL	INDIVIDUALS	CORPS.	FNDS.	ENDOWMENT INCOME	FEES & OTHERS
BILLIONS OF $	90	33	57	12	2	3	2	38
%	100	37	63	13	2	3	2	43
AS % OF GNP ($2,108 BILLION)	4.3	1.6	2.7	.6	.1	.1	.1	1.8

1

PLANNING AND EVALUATION CYCLE

DESCRIBE THE WORLD AND HOW IT WORKS

SYSTEMS ANALYSIS/MODELS/PARADIGMS

IMPROVING THE SYSTEM

DEFINE VALUES/IDENTIFY DESIRED CHANGES/DEFINE THE PROBLEM

DEVELOP CHANGE STRATEGIES

POLICIES (PUBLIC AND PRIVATE)/PROGRAMS/PROJECTS TO ACHIEVE
DEFINED GOALS/OBJECTIVES/SOLUTIONS AND ESTABLISH
KEY INDICATORS OF PROGRESS AT EACH LEVEL OF SIGNIFICANT ACTIVITY

CARRY OUT POLICIES/PROGRAMS/PROJECTS

STEERING OR FORMATIVE EVALUATION
INVOLVES INTERACTION BETWEEN EVALUATOR AND EVALUATED
ONGOING SELF-EVALUATION ALSO USEFUL

SUMMATIVE APPRAISAL OF FINISHED WORK TO IDENTIFY

SUCCESSES/FAILURES
REASONS THEREFOR
WHAT TO DO NEXT

EXTERNAL EVALUATIONS OF PROPRIETARY BUSINESS AND PRIVATE NON-PROPRIETARY PHILANTHROPIC ORGANIZATIONS

	PROPRIETARY BUSINESS ORGANIZATIONS	NON-PROPRIETARY ORGANIZATIONS
OWNERSHIP	EXTERNAL/TRANSFERABLE VIA TWO-WAY EXCHANGE	INTERNAL/NOT TRANSFERABLE
OPERATING RESULTS	REPORTED QUARTERLY AND ANNUALLY TO OWNERS AND PUBLIC	AVAILABLE ANNUALLY ON DEMAND
OVERALL EVALUATION BY	FINANCIAL ANALYSTS IN INVESTMENT BANKS/BROKERAGE FIRMS/BANK TRUST DEPTS./ INSURANCE COS./ CREDITORS SEC/FTC/IRS	IRS/STATE AGENCIES/ACCREDITATION BODIES
VALUE OF ASSETS	SHARE PRICES QUOTED DAILY	NO ESTABLISHED MARKET
BASIC PERFORMANCE INDICATORS	RETURN ON INVESTMENT SHARE PRICES PAYMENT OF DIVIDENDS	SIZE OF BUDGET
PRODUCTS	PRICES REFLECT TOTAL COSTS - FULLY SUBJECTED TO MARKET TESTS	PRICES SUBSIDIZED-MARKETS NOT FULLY COMPETITIVE
	EVALUATED BY NATIONAL CONSUMER ORGANIZATIONS/GOV'T REGULATORS	LESS LIKELY TO BE EVALUATED

EVALUATION PRACTICES EMPLOYED BY PROPRIETARY BUSINESS ORGANIZATIONS - I

	FUTURE ORIENTATION	EVALUATION OF COMPETITORS	EVALUATION OF COMPETING STRATEGIES
MARKETING	CONSUMER NEEDS	MARKET SHARE STRENGTHS/WEAKNESSES PRODUCT QUALITY/PRICE/ PERFORMANCE	PRICE/QUALITY/ QUANTITY MARKET PENETRATION MARKET SHARE ADVERTISING
RESEARCH AND MANUFACTURING	PERFORMANCE STANDARDS TO MEET FUTURE COMPETITIVE REGULATORY REQUIREMENTS	TECHNOLOGY PATENTS	PROCESS ALTERNATIVES ENGINEERING DESIGNS PLANT SIZE MAKE/BUY ANALYSIS
FINANCE	REQUIREMENTS FOR INVESTMENT AND WORKING CAPITAL DISCOUNTED CASH FLOW INCOME AND P&L RISK ANALYSIS	RATIO ANALYSIS REVENUE GROWTH RATE NET PROFIT MARGINS GROSS PLANT/REVENUE PRICE/EARNINGS	COMPARATIVE DCF ANALYSIS OF COMPETING STRATEGIES FOR MARKETING, MANUFACTURING, FINANCING

EVALUATION PRACTICES EMPLOYED BY PROPRIETARY BUSINESS ORGANIZATIONS - II

	PRELIMINARY TESTING	CONCENTRATION ON FEW KEY INDICATORS	MULTI-FUNCTIONAL ORIENTATION
MARKETING	PRODUCT PERFORMANCE/SAFETY TEST MARKETING PANELS/LOCATIONS ADVERTISING	PRICE SALES GROWTH MARKET SHARE MARGIN	(PHASED GRADUAL (INTENSIFICATION (OF MARKET, (ENGINEERING, (FINANCIAL EVALU- (ATION AND PLAN- (NING IN PARALLEL (WITH RESEARCH (DEVELOPMENT
RESEARCH AND MANUFACTURING	IDEA LAB FEASIBILITY PROCESS DEVELOPMENT PILOT PLANT SEMI-COMMERCIAL COMMERICAL	SYSTEM OPTIMIZATION CAPACITY UTILIZATION DOWN TIME COST PER UNIT	((PROJECT MANAGER (HAS MULTI-FUNC- (TIONAL ADVISORY (GROUP CHAIRED BY (REP. FROM PROFIT (CENTER WHICH (SPONSORS PROJECT
FINANCE	FINANCING TECHNIQUES DEBT/EQUITY RATIOS COMMERCIAL PAPER DUTCH AUCTIONS PORTFOLIO MANAGEMENT	DISCOUNTED CASH FLOW PROFIT AND LOSS	((MANAGEMENT (DEVELOPMENT IN- (CLUDES ASSIGN- (MENT TO VARIED (FUNCTIONS AND (LOCATIONS